FILE COPY.

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1906

No. 163

Office Supreme Court, U.S.
FILED.
JAN 7 1907
JAMES H. McKENNEY
Clerk

EAU CLAIRE NATIONAL BANK,

Plaintiff in Error.

vs.

RALPH W. JACKMAN, as Trustee of the Estate of JOHN H. YOUNG, Bankrupt,

Defendant in Error.

In Error to the Supreme Court of the State of Wisconsin.

Brief and Argument of Plaintiff in Error

BURR W. JONES,
JAMES WICKHAM,
FRANK R. FARR,

Counsel for Plaintiff in Error.

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1906

No. 163

EAU CLAIRE NATIONAL BANK,
Plaintiff in Error,

vs.

RALPH W. JACKMAN, AS TRUSTEE OF THE ESTATE OF JOHN H. YOUNG, BANKRUPT,
Defendant in Error.

ERROR TO THE SUPREME COURT OF THE STATE OF WISCONSIN

Brief and Argument of Plaintiff in Error

Statement of the Case.

The Pleadings

The suit was commenced by the defendant in error as plaintiff in the Circuit Court of Eau Claire County, Wisconsin, by the service of a summons and complaint on July 7, 1902 (record 7).

The complaint alleged that on June 7, 1902, John H. Young was adjudged a bankrupt in the District Court of the United States for the Western District of Wisconsin; that on June 23, 1902, Ralph W. Jackman was appointed trustee; that the Eau Claire National Bank was a banking corporation, organized under the laws of the United States (record 2); that Young owned certain logs and lumber worth $35,000.00; that Young owed the bank $27000.00 (record 3); that on February 10, 1902, Young, while insolvent executed to the Bank a chattel mortgage on certain logs and lumber to secure his indebtedness to the bank (record 4); that on March 10, 1902, Young transferred to the bank the logs and lumber covered by the chattel mortgages, together with certain other logs, by making a bill-of-sale thereof to the Waters-Clark Lumber Company as nominal vendee, but which Lumber Company was alleged to be acting for and in behalf of the bank. It was also alleged that

this transfer was in violation of the bankrupt law; that it constituted an unlawful preference, and enabled the bank to obtain larger percentage of its debt than other creditors of the same class (record 4, 5); that the bank in this manner appropriated the bankrupt's property to the payment of its own indebtedness to the value of $35,000, for which sum judgment was demanded (record 6.) The bank demurred to the complaint, on the ground, among others, that the complaint did not state facts sufficient to constitute a cause of action (record 8.) This demurrer was over-ruled by the trial court (record 10).

The bank answered, admitting that Young was adjudged a bankrupt; that Jackman was appointed trustee; that the bank was a banking corporation; that in February 1902, Young executed and delivered to the bank certain chattel mortgages on certain logs and lumber (record 11), alleging that in March, 1902, Young sold the logs and lumber to the Waters-Clark Lumber Company; that the proceeds of such sale were used to pay certain liens against the property. The answer also denied all the allegations of the complaint not expressly admitted, and contained the following allegation: "That neither the said mortgages, nor the payments made to the defendant as aforesaid, were made, given or received for the purpose of giving the defendant a preference over other creditors of said Young, contrary to the provisions of said bankruptcy law" (record 12). The trustee based his right to recover on the provisions of the bankrupt act. The bank defended, basing its right to hold what property it received and its immunity from liability on the provisions of the bankrupt act. The bank, by its answer, specially set up and claimed that the mortgages and payments it received were not given or received in violation of the provisions of this Federal statute.

The Trial in the State Court.

The case was tried before the court and a jury. A special verdict was rendered covering some of the issues in the case (record 14-15). Some of the issues in the case were decided by the court without a jury (record 17,18). Many of the issues in the case were determined by the undisputed evidence upon which no finding was made, either by the court

or the jury. On September 18, 1903, the trial court ordered judgment in favor of the trustee and against the bank for $6254.99, with interest and costs (record 408, 409). On the same day such judgment was entered, amounting with interest and costs to $6843.77 (record 22,23). The trial court made a decision in writing, which has been incorporated in the bill of exceptions, showing the grounds upon which its decision is based (record 394 to 404).

The Appeal to the State Supreme Court.

Both parties appealed to the Supreme Court of the State of Wisconsin, in which court the judgment of the Circuit Court was affirmed on both appeals on June 23, 1905 (record 435); both parties filed motions in the State Supreme Court, for a rehearing (record 460, 462), and both motions for a rehearing were denied by the State Supreme Court on October 3, 1905 (record 462). See *Jackman, Trustee, v. Eau Claire National Bank*, 125 Wis. 465.

The State Supreme Court, by Justice Kerwin, filed an opinion which has been made a part of the record (record 437, 460). The Chief Justice of the Supreme Court of the State also made a certificate, certifying to certain Federal questions in addition to those mentioned in the court's opinion, which were specially set up and claimed by the bank as a right and immunity of the bank, and also certifying that said questions were considered by the court and decided adversely to the bank, which certificate is also made a part of the record (record 466, 467).

To review the judgment rendered against it, the plaintiff in error has brought the cause to this Court by a writ of error issued to the State Supreme Court.

The Transfers of the Bankrupt's Property.

The evidence shows that the chattel mortgages dated February 10, 1902, were in fact delivered on or about February 20, 1902. The mortgages and notes which they secured were given as collateral security for what Young was then owing the bank on promissory notes and time checks given for labor claims performed on the logs and lumber and also to secure further advances which the bank should make upon other similar time checks which should thereafter come into the hands of the bank (record 108, 313). The

mortgages were never foreclosed. The property was not taken by the bank, but the mortgages were released afterwards when Young sold the property to the Waters-Clark Lumber Company. (Record 56, 86.) The allegations of the complaint to the effect that in the sale of the logs and lumber the Waters-Clark Lumber Company acted as trustee or agent of the bank is not sustained by any evidence, but on the contrary, the evidence shows that this property was sold to the lumber company in the usual course of business (record 313, 340, 350). Findings 3 and 4 of the special verdict bearing on this subject (record 14) are somewhat ambiguous, but both the trial court (record 399) and the State Supreme Court (record 447, 448) held that the evidence did not sustain this allegation of the complaint. On this question the Supreme Court said: "However the evidence seems to clearly establish that the Lumber Company purchased the property from Young in the regular course of business, without any understanding with the defendant other than that its interest in the property as mortgagee and claimant under numerous statutory labor liens, should be recognized and the equivalent thereof in money delivered to it out of the proceeds" (record 448).

The lumber was sold March 3, 1902 (record 39) and the logs were sold March 29, 1902 (record 40).

The following statement shows the sales that were made of the property in question and the disposition of the proceeds.

Sales of Property.

Lumber sold by Young to Waters-Clark Lumber Company (record 39, finding 2, record 17)	$ 3452 85
Cadott logs sold by Young to Waters-Clark Lumber Company (record 40, 18, 21)	10077 85
Up-river logs sold by Young to Waters-Clark Lumber Company (record 40, 18, 21)	11055 84
Amount Waters-Clark Lumber Company overpaid Young by mistake (see stipulated facts, record 374, 375; also record 457, 458)	413 03
Total proceeds of sales	$ 24999 56

Disposition of Proceeds.

Note of Waters-Clark Lumber Company to Young for lumber and by Young endorsed to bank (record 39, finding 3, record 18, 21)	$ 3452 85	
Lienable labor claims on Cadott logs paid out of proceeds of sale of logs (record 374)	8212 35	
Lienable labor claims against up-river logs, paid out of proceeds of sale of logs (record 375)	6052 46	
Amount paid out of proceeds of logs to William McKinnon for his interest in logs (record 375)	2627 95	
Amount paid to other persons out of proceeds of up-river logs for their interest therein (record 375)	1039 81	
Amount paid bank for non-lienable time-checks held by bank, Ferbruary 20, 1902 (record 375)	700 00	
Amount paid for non-lienable time-checks acquired by bank between February 20th and March 29th, 1902, and secured by bank's mortgage (record 375, 403)	406 00	
Note of Waters-Clark Lumber Company to Young for net proceeds of sale of logs and by Young transferred to the bank (record 18, 21, 83)	2508 14	
Total		$ 24999 56

The Judgment was Arrived at by Charging the Bank with the Following Items (record 403, 458):

Note for purchase price of lumber of Waters-Clark Lumber Company to Young and transferred by Young to the bank	$	3452 85
Note for net proceeds of logs from Waters-Clark Lumber Company to Young and by Young transferred to bank		2508 14
Cash paid bank for non-lienable time-checks held by bank, February 20, 1902		700 00
Total	$	6660 99

Cr.

Amount by mistake overpaid to Young on purchase price of logs, $413.03, less $7.03 omitted by another mistake (record 458).....	$ 406 00	406 00
Amount of judgment against bank, without interest and costs (record 403).....		$6254 99

Up-River Logs.

The up-river logs were not included in the bank's mortgage. The bank held two mortgages, one on the lumber and one on the Cadott logs (record 64, 66). The Cadott logs were located 2 to 4 miles from Cadott (record 41). The up-river logs were located from 10 to 22 miles from Cadott (record 39). The chattel mortgage on the logs covered only the Cadott logs (record 64). The bank held no mortgage on the up-river logs (record 85, 311, 389).

There is included in the judgment rendered against the bank the sum of $1335.62 as the net proceeds of the sale of the up-river logs, after paying other claims against them. This fact appears by the undisputed evidence (record 95, 96). It also appears from the findings of the court and the stipulated facts as is shown by the following statement:

The purchase price of the up-river logs (record 40) and value as found by the court (record 21).....		$11055 84
It was stipulated (record 375) that the proceeds of this sale was applied as follows:		
Applied to payment of lienable claims.....	$6052.46	
Paid William McKinnon.....	2627.95	
Paid other persons amounts due on logs.....	1039.81	9720.22
Balance of proceeds of sale of up-river logs...		$1335.62

This balance of $1335.62 formed a part of the consideration of the note of $2508.14 given by the Waters-Clark Lumber Company to Young, as the net proceeds of the sale of the two last lots of logs, and by Young transferred to the bank (record 95, 96).

The State Supreme Court in its opinion apparently supposed that the up-river logs were covered by the bank's mortgages, and held that the bank was liable only to the extent of its chattel mortgage

interest in the logs and lumber which finally came into its possession in the form of money (record 447). The court also, after referring to the fact that the judgment was excessive in the sum of $7.00, said: "The amount of the judgment, as we view the matter, is substantially the equivalent of the property which the defendant secured by its mortgages. That is all the property as appears from the record which it obtained in fraud of the bankrupt act" (record 458).

Young's Indebtedness to Bank.

The following is a statement of the amount owing by Young to the bank on March 29, 1902, not including lienable claims held to be valid security, but including payments for which the bank was held liable:

Date.	*Face.*	*Prin.*	*Int.*	*Total.*	*Exhibit*
April 2, 1900	$8000.00	$4145.34	$948.22	$5093.56	F
Oct. 15, 1900	4902.98	243.93	348.65	592.58	S
January 1, 1901	4350.90	4176.46	423.69	4600.15	R
April 15, 1901	6593.31	6511.84	501.57	7013.41	Q
July 15, 1901	5236.07	4613.93	283.05	4896.98	P
October 15, 1901	361.66	361.66	13.18	374.84	O
Mill Supply Co. Note				377.00	
Non-lienable time checks held Feb. 20, 1902				700.00	
Total				$23648.62	
Paid on above out of proceeds of sales for which judgment was rendered				6254.99	
Balance still unpaid				$17393.53	

Percentage of bank's claim collected, $6254.99 ÷ $23648.52 —26¼ per cent.

(Record 104 to 107; also copies of notes with endorsements, record 423 to 428).

Young's Indebtedness to Other Creditors.

The following is a statement of debts owing by Young to creditors other than the bank on February 20, 1902, on which unsecured claims were filed in the bankruptcy proceeding:

Standard Oil Co.	$ 36.89
E. A. Martin	75.00
Sallie F. Moon	5360.14
Dells Milling Co	51.92
Nichols, Dean & Gregg	69.65
D. Shaw Lumber Co	104.62
W. J. Davis	90.68
A. A. Cutter	35.45
W. S. Monroe	25.00
S. R. Keiser	50.00
Fritz Miller	50.00
J. M. Vizenda	48.90
Peter Dietzler	40.88
Henry Frazle	117.60
Alex. Lentz	160.00
Frank Zimmerman	25.00
Swift & Co	24.75
S. C. Brooks	95.65
Eau Claire Grocer Co	1496.68
Eau Claire Mill Supply Co	373.37
	$8322.18

(Record 98, 99 and 144 to 148.)

The statement does not include a claim of the Valley Lumber Company, of $2500.00, for the purchase price of certain mill property in the City of Eau Claire, which claim was secured by a contract for a deed of the property (record 247). After this contract was made, extensive improvements were made on the property, and a large amount of mill machinery was attached to the real estate in such a way as to make it a part of the freehold (record 138, 232). There was no evidence that this mill property, together with the added improvements and machinery, was not adequate security for the payment of this claim. The claim was filed in the bankruptcy court as a secured claim. No portion of it being filed or allowed as being an amount in excess of the value of the security (record 99, 271, 265).

Some other claims were filed in the bankruptcy court, but no proof was offered to show that Young ever owed any of them. The proof expressly shows that Young did not owe such claims on February 20, 1902 (record 148). Some

of these claims purport to have been incurred after the time of the transfer in question. The evidence that such claims were filed was not offered as proof of the existence of the indebtedness. Counsel for the trustee expressly stated at the time that they were not offered for such purpose (record 263).

The total claims filed in the bankruptcy proceeding amount to $12355.54 (record 98, 99).

The Bank's Information of Young's Indebtedness at the Time of the Making of the Transfers in Question.

On February 1, 1902, shortly before the mortgages were given, Young submitted to the bank an itemized statement in writing of his assets and liabilities, which statement showed that his property was worth $42241.25, that he was owing labor claims amounting to $822.59, and that all his other debts, aside from what he was owing the bank, amounted to $1328.77 (record 421, 422). These labor claims, amounting to $822.59, were paid out of the proceeds of the sale (record 60, 91). A few days afterwards, Mr. C. W. Lockwood and D. S. Clark, officers of the bank, went to Young's place of business and made a careful examination of his books and accounts to ascertain his financial condition (record 75). From such information as they could get, the entire outstanding indebtedness of Young at that time, aside from what he was owing the bank, and aside from what was paid out of the proceeds of the sale, was $1353.90. They took a written memorandum of these items, showing the names and amounts which Young informed them was the extent of his indebtedness (record 88). This evidence is undisputed. Two of these claims were afterwards paid, one being the claim of C. W. Cheney & Co. for $82.50, which was afterwards paid by the bank, and the other being the claim of J. A. Smith for $300.00, which he afterwards collected from some insurance money (record 306). The claim of E. M. Fish Company for $350.00 was for work done on Young's house in Eau Claire, worth $4500.00 (record 89,90), and which under the Wisconsin Statutes would be secured by mechanic's lien upon the property. Young stated that he would borrow the money on the house to pay the claim of E. M. Fish Company (record 89). Young testified that he informed W. K. Coffin, an officer of the bank,

of his indebtedness to Mrs. Moon and his indebteness to the Valley Lumber Company (record 156). In this he is contradicted by the positive testimony of Mr. Coffin (record 307), who is corroborated by Mr. Keith (record 342); also by Young's written financial statements (record 415 to 422) and by the circumstance that the bank continued to advance money to Young without security.

Under this evidence, without taking into consideration the debts that Young was owing to the bank and the claims paid out of the proceeds of the sale of the property, and without including the claim of the Valley Lumber Company, which was secured, the following is a statement of the entire debts of Young of which the bank or any of its officers had any notice or information at the time of the transactions in question.

The statement is based on the evidence most favorable to the trustee.

Debts according to statement furnished Lockwood $1353.90 (record 88), less item of C. W. Cheney $82.00 in the meantime paid by the bank (record 306)	$1271.90
Claim of J. A. Smith, shown in statement of February 1, 1902 (record 422)	300.00
Mrs. Moon's note, with interest, less $600 payment (record 155)	5835.00
Total	$7406 90

Property worth 26⅓ per cent of $7406.90, or $1962.82, would have been sufficient to pay these creditors a percentage equal to that received by the bank.

The Bank's Information of What Property Young Has Left Available for the Payment of Other Debts

At the time of the transfers in question, the bank had information which its officers believed, and were justified in believing, that Young had other property left outside of his homestead amply sufficient to pay in full the claims of all his other creditors.

According to the information of Mr. Lockwood, Young had property left, not including his home, worth $22267.69 (record 90). According to the information of Mr. Coffin, Young still had property worth $25,380.00 (record 315).

These estimates were based upon Young's written statements, and on such other information as the bank could obtain. Young shortly afterwards claimed to have cash in his pocket to the amount of $2000.00. He so informed Mr. Lockwood, according to the undisputed evidence (record 87).

According to the undisputed evidence, and making all reasonable allowances and deductions for any conflict there may be in the evidence, the officers of the bank believed, and were justified in believing, that on March 29, 1902, Young had property left outside of his homestead, available for the payment of the claims of other creditors, of which the following are some of the more important items:

Accounts receivable	$3000.00
Insurance (record 330)	1000.00
40 acres of land	280.00
Camp outfit, horses, wagons, hay, etc., at least	2000.00
Lath and shingles and other proceeds	1500.00
2 million feet of pine stumpage	6000.00
300 thousand feet of hard-wood stumpage	900.00
Total of above items,	$14680.00

(Record 81, 82, 88, 90, 314, 315, 330, 421, 209, 210.)

Illegal Preferences Collected by Other Creditors.

Sallie F. Moon filed an unsecured claim in the bankruptcy court for $5360.14, on a promissory note of $6090.00 and interest, and on which note was endorsed $1059.86 as paid on April 24, 1902 (record 264, 265). This claim was allowed in the bankruptcy court for the full amount less the payment (record 96).

The evidence shows that about that time Young made this payment, and that about $600.00 of the payment was made shortly before February 20, 1902, in the proceeds of shingles and lath sold the Northwestern Lumber Company (record 154).

W. S. Monroe filed in the bankruptcy court an unsecured claim for $25.00 which was allowed (record 98). The evidence shows that on March 12, 1902, Young paid Mr. Monroe $1672.05, partially in cash and partially in logs that were mortgaged to the bank (record 175½, 176). Young said he knew at that time he had not sufficient property to pay his debts (record 255).

If the claims of Sallie F. Moon and W. S. Monroe were deducted from the total amount of the debts of the bankrupt's estate which he was owing at the time of the transfers in question (these claims not being provable under the bankrupt law), the sum total of the other debts which could be affected by the alleged preference would not exceed $2897.04.

The Questions Involved and the Manner in which They are Raised.

Question 1—Can a trustee in bankruptcy under the provisions of the bankrupt act, lawfully maintain a suit to recover the value of a voidable preference without first electing to avoid such preference by notice to the creditor receiving such preference, and by demand for its return?

How Question Raised. The complaint contains no allegation that the trustee gave such notice, or made such demand, before commencing the suit. The defendant demurred to the complaint as not stating facts sufficient to constitute a cause of action (record 8). The trial court overruled the demurrer (record 10), to which order due exception was taken (record 35). In the State Supreme Court error was assigned to this ruling, which assignment of error the State Supreme Court overruled (record 445).

Question 2—Can the trustee in bankruptcy under the bankrupt act, lawfully recover judgment for the value of a voidable preference without in any manner electing to avoid such preference, and without suing to avoid it, but merely by suing to recover some alleged preference that the creditor did not receive, and by recovering judgment for another and different alleged preference after the year has expired in which the creditor might have surrendered the preference received and filed his claim in the bankruptcy court under section 57g and 57m of the bankrupt act? And is this the legal effect of the facts disclosed by the record in this case?

How Question Raised. The suit was brought to recover $35,000.00, the value of logs and lumber alleged to have been sold by the bankrupt to the bank. The evidence shows that the logs and lumber had been sold by the bankrupt to the Waters-Clark Lumber Company, and that the bankrupt transferred to the bank a portion of the proceeds

of the sale consisting of promissory notes and moneys amounting to $6254.99, for which sum judgment was rendered. The trustee did not at any time, either before or during the trial, elect to take judgment for the amount for which judgment was rendered, but contended that the bank was liable for the entire value of the logs and lumber. The trustee moved for judgment for such value and for certain portions of such value, all of which motions the trial court overruled, and ordered judgment for the amount for which judgment was entered on the court's own motion (record 409). The trustee did not even then elect to accept said judgment, but appealed to the State Supreme Court and endeavored to recover a judgment for the entire value of the logs and lumber.

The trial court held, "the bank received the notes and not the logs and lumber" (record 399). The trial court also held: "It is the opinion of this court that a recovery may be had for the value of that which the bank received—the notes" (record 402).

Error was assigned in the State Supreme Court upon this ruling, and that the court held that the judgment should be sustained under the bankrupt act, on the ground that what the bank received, and for which judgment was recovered, "was its mortgage interest obtained in fraud of the bankrupt act" (record 453). The State Supreme Court also held that the amount of the judgment was the equivalent of the property the bank secured by its mortgages, and also said: "That is all the property as appears from the record which it obtained in fraud of the bankrupt act" (record 458).

The record shows that the suit was not brought to set aside the lien of the mortgages, that the mortgages and the liens thereof had gone out of existance at the time of the sale of the property to the Waters-Clark Lumber Company, that what the bank received was received by virtue of another transfer made by Young of certain notes and moneys which were transferred absolutely and not as security, and that of this amount, $1335.62 was the proceeds of the sale of the up-river logs in which the bank never had any interest as owner, purchaser, mortgagee or otherwise. The record also shows that the adjudication in bankruptcy was on June 7, 1902 (record 2, 11), and that the judgment was recovered on September 18, 1903 (record 22), after the time

had expired in which the bank might have surrendered any preference it received, and filed its claims in the bankruptcy court had the trustee elected to avoid such a preference.

This presents the question: Is the bank liable under the provisions of the bankrupt act, either for the $1335.62, or for any portion of the amount for which the judgment was rendered?

Question 3 — At the time of the transfers in question, Young owed debts of different kinds, as follows: (1) claims of general creditors that were unsecured; (2) claims secured by contract and statutory liens on Young's property; (3) claims secured by indorsements of sureties, and (4) wages due workmen and servants which had been earned within three months before that time (record 211). The claims of wages for workmen and servants were paid in full out of the proceeds of the sale. A portion of the proceeds was applied to the payment of the claims of persons who had liens on the property, and a portion of such proceeds was paid to the bank which held certain claims of the first three kinds mentioned. Certain other claims were filed and allowed in the bankruptcy proceeding, as preferred claims (record 99). These were probably claims for wages earned after the time of the transfers in question.

One of the questions involved is, Are these various kinds of creditors, all creditors of the same class within the meaning of section 60a of the bankrupt act?

How Question Raised. The trial court in its charge to the jury on the subject of whether or not the bank had received a preference, charged the jury that these creditors were all creditors of the same class within the meaning of section 60a of the bankrupt act (record 385). Due exception was taken to this charge (record 391, 392). Error was assigned in the State Supreme Court to this portion of the charge, and that court held that is was immaterial whether the charge was right or wrong, because that question would not arise until the time when the trustee come to administer the property which he sought to recover in this suit, and that if the property was obtained by the bank in fraud of the bankrupt act, the bank was liable in any event (record 449). The State

Supreme Court entirely overlooked the fact that under the provisions of the bankrupt act, it would be impossible to ascertain whether or not a preference had been received without first determining the question of whether the enforcement of the transfer would enable the bank to recover a greater percentage of its debt than other creditors of the same class.

Question 4—Under section 60a of the bankrupt act, does it constitute a preference for a creditor to receive from an insolvent debtor a certain percentage of the creditor's claim, where the debtor has other property left amply sufficient to enable all other creditors of the same class to obtain an equal percentage of their claims?

How Question Raised. The jury found against the bank on questions 9 to 12, inclusive, that the officers of the bank had reasonable cause to believe that a preference was intended (record 15).

In the state court the bank contended that on a proper construction of the word "preference" the evidence was insufficient to sustain this finding (record 456).

In the State Supreme Court facts and figures were shown demonstrating that under a proper construction of the bankrupt act, that there was no evidence to sustain this finding. The evidence showed, (1) that the bank's claim was a large claim—more than twice the amount of claims of all other creditors combined;— (2) that it collected by virtue of the transfers in question only 26½ per cent of its claim; (3) that from all the information the bank had, according to the evidence most favorable to the trustee, it was unable to discover other debts which could be affected by the transfer to an amount in excess of $7406.90; (4) that from all the information that the bank had, or could obtain, Young had ample property left with which to pay all his other creditors in full; and (5) that from such information the sum of $1962.82 would have been sufficient to enable Young to pay other creditors of the same class an equal percentage to that received by the bank.

The State Supreme Court refused to set aside the finding, basing its decision upon what we contend was an erroneous view of the bankrupt act. The State Supreme Court

sustained this finding on the ground that the word "preference" means the collection by the creditor of *any portion* or *any percentage* of the creditor's claim against an insolvent debtor. The State Supreme Court held that the evidence was sufficient to prove that Young was insolvent, and that the bank was chargeable with notice of such insolvency, and that when those two facts were shown, that if the bank received any percentage of its claim, that it necessarily followed as a matter of law that it received a preference (record 456).

The question presented to this Court is, Was there error in the decision of the State Supreme Court in its construction of this Federal statute as to the meaning of the word "preference" in section 60a of the Bankrupt Act?

Question 5—Does the trustee in bankruptcy, suing to recover an alleged voidable preference, represent the creditors who are entitled under the law and evidence to share in the distribution of the estate of the bankrupt, and is the amount which he is entitled to recover limited to such sum as is necessary to pay, with interest and costs, the claims of such persons as the evidence shows were in fact creditors who held claims which were provable and proven in the bankruptcy court? Can anything be collected to pay fictitious claims that are not supported by any proof? Can anything be collected to pay claims of creditors who had themselves received preferences and whose claims were not entitled to be filed or allowed in the bankrupt court? Can anything be collected for the benefit of the bankrupt for the purpose of returning it to him under section 66b of the Bankrupt Act?

How Question Raised. (a) The complaint contains no allegation that the claim of any creditor had been filed in the bankrupt court. It contains no allegation of what sum, if any, was necessary to be recovered from the bank to enable the trustee to pay claims of creditors. The bank demurred to the complaint on this ground among others. It objected on this ground, both in the circuit court and in the Supreme Court, to the sufficiency of the complaint, but its objections were overruled

(b) The evidence in the case showed what debts Young owed on February 20, 1902, the time of the giving of the

mortgages. The sum total of these debts, on which unsecured claims were filed in the bankrupt court, was $8322.18. (See statement under heading "Young's indebtedness to other creditors.")

Two creditors, whose claims amounted to $5655.14, and included in the above amount, had themselves received preferences, but notwithstanding that fact had filed their claims in the bankrupt court for the balance due them. See statement of fact under heading "Illegal preferences collected by other creditors.")

Certain other claims were filed in the bankrupt court, some of which purported to have accrued after the time of the transfers in question, but no evidence was offered to prove that any such indebtedness ever existed.

If the recovery had been limited to the amount necessary to pay the claims of such persons as were shown by the evidence in the case to be creditors of the bankrupt whose claims were proven in the bankrupt court, and entitled by the bankrupt act to be so proven, no recovery could have been had in excess of $2667.04, with interest and costs. These questions were presented by the bank to the State Supreme Court, and were by that court decided against the bank. That court held that section 60b of the bankrupt act made a creditor receiving such preference absolutely liable for the entire value of the preference received, without regard to the question of what, if any, claims were filed in the bankrupt court (record 446). What the court then said was with reference to the sufficiency of the complaint. The court, in its opinion, again used similar language in passing on the question of the assignment of error to the charge that the creditors were all of the same class (record 449). The questions of the right of the trustee to recover for the purpose of paying fictitious claims or claims unsupported by evidence or claims of persons who had themselves received preferences, are not specifically mentioned in the opinion, undoubtedly for the reason that what the court had said on the question of the sufficiency of the complaint, also applied to those questions; but it is shown by the certificate of the chief justice of the state court that those questions above referred to, not specifically mentioned in the opinion, were on the hearing

before the State Supreme Court specially set up and claimed by the bank as a right and immunity under the bankrupt act, and that on said hearing said questions were considered by the court, and were by it decided adversely to said bank (record 466-467). It appears by the record that these questions were involved. It appears by this certificate that they were specially set up and claimed, and it appears, both by the certificate and by the judgment of the State Supreme Court, that they were decided adversely to the bank.

Specification of Errors Relied Upon.

First—The Supreme Court of the State of Wisconsin erred in determining that the complaint of the defendant in error (the plaintiff in the state court) stated a cause of action, and in refusing to reverse the judgment rendered in favor of the defendant in error (the plaintiff in the state court) in the Circuit Court of Eau Claire County, for the failure of said complaint to state facts sufficient to constitute a cause of action.

Second—The said Supreme Court of the State of Wisconsin erred in determining that the defendant Eau Claire National Bank (plaintiff in error herein) was liable in said action for the value of the logs and lumber described in the plaintiff's complaint to the extent of the chattle mortgage interest of the defendant (plaintiff in error) therein.

Third—The said court erred in determining that the defendant (plaintiff in error) was liable in said action for having received as a preference, contrary to the provisions of section 60a and section 60b of the Bankrupt Act of July 1, 1898, as a portion of its chattel mortgage interest in said logs, the sum of $1335.62 as the proceeds of the sale of the portion of said logs known as the "up-river-logs," on which logs said defendant (plaintiff in error) never held any chattel mortgage, and which logs were never transferred to said defendant (plaintiff in error).

Fourth—The said court erred in determining that the defendant (plaintiff in error) was liable in said action for the value of those certain notes and moneys it had received for which the judgment in said action was rendered against it, as a preference, under the provisions of said Bankrupt Act, although the plaintiff trustee (defendant in error) had

not elected to avoid such preference by bringing suit to recover the same, and had not elected to avoid such preference in any manner whatever.

Fifth--The said court erred in determining that in order to ascertain whether or not the defendant (plaintiff in error) was liable for having received a preference under the provisions of the Bankrupt Act, it was immaterial whether or not the creditors of the bankrupt were all creditors of the same class, and said court erred in refusing to reverse said judgment because of the error of said circuit court in charging the jury that all the creditors of said bankrupt were creditors of the same class. The said charge on said subject being as follows: "So far as creditors' rights are involved in this action, they are all of the same class, by which is meant that they would all receive the same percentage of their claims. Claims for taxes or wages within certain times so as to be preferred, would be of a different class, but claims of creditors like those proven in the Young bankruptcy proceedings are all of the same class."

Sixth—The said court in determining that the defendant (plaintiff in error) had reasonable cause to believe that a preference was intended, erred in the construction of said Bankrupt Act in the following respects:

(a) In determining that where the effect of the enforcement of a transfer from an insolvent debtor is to enable any of his creditors to obtain any portion of his debt, and that transfer is followed within four months by the commencement of bankruptcy proceedings, that such a transfer would necessarily enable such creditor to obtain a greater percentage of his debt than other creditors of the same class, and would constitute a preference within the meaning of said Bankrupt Act;

(b) In determining that, although the effect of the enforcement of the transfer in question did not operate to give the defendant (plaintiff in error) a greater percentage of its debt than other creditors of the same class, that nevertheless such transfer constituted a preference within the meaning of said Bankrupt Act;

(c) In determining by such rules of construction of said Bankrupt Act that the evidence was sufficient to sustain

the finding that the defendant (plaintiff in error) had reasonable cause to believe that a preference was intended, whereas under a proper construction of said Bankrupt Act it appears by the uncontroverted evidence that said defendant (plaintiff in error) did not have reasonable cause to believe that a preference was intended;

Seventh—The said court erred in determining that the defendant (plaintiff in error), having received a preference which was voidable by the trustee, was for that reason liable in said action for the full value of such preference so received in an amount in excess of what was necessary to pay all the other creditors of said bankrupt;

Eighth—The said court erred in determining that the defendant (plaintiff in error) was liable to the plaintiff trustee (defendant in error) for moneys required by said trustee to pay claims of fictitious creditors whose claims were not proven by the evidence and claims of creditors who had themselves received preferences, and in giving judgment against defendant therefor;

Ninth—The said court erred in refusing to limit the recovery against the defendant (plaintiff in error) to such sum as should be sufficient, after the payment of expenses and costs, to pay all the other creditors of the bankrupt whose claims were provable and proven and entitled to be allowed under the provisions of the Bankrupt Act;

Tenth—The said court erred in affirming the judgment rendered against the defendant (plaintiff in error) in said action, and in refusing to reverse said judgment;

Eleventh—The said court erred in refusing to determine that the defendant (plaintiff in error) was entitled to judgment, and in refusing to direct judgment to be entered in its favor.

Argument and Authorities

The questions involved in this case depend upon the construction of the Federal bankrupt act of 1898. The transaction out of which the suit arose, the adjudication in bankruptcy, and the commencement of the suit, all took place in the year 1902, and prior to the amendment

of the bankrupt act of February 5, 1903. What is said in this brief in reference to the bankrupt act therefore refers to the act as it stood before the amendment. The decision in the State court is *Jackman, trustee, v Eau Claire National Bank*, 125 Wis. 465.

Jurisdiction of This Court.

The questions raised by the specification of errors are all Federal questions, involving the construction of the Federal bankrupt act. These questions were all specially set up and claimed in the state court by the plaintiff in error as a right and immunity under this Federal statute. Most of the questions are shown by the opinion of the State Supreme Court to have been there raised and to have been decided adversely to the plaintiff in error (record 437 to 460), and the other questions not expressly mentioned in the opinion are shown by the certificate of the Chief Justice of the State Supreme Court to have been specially set up and raised and decided adversely to the plaintiff in error (record 466, 467). Substantially all of the questions that were involved in the bank's appeal to the State Supreme Court, are the same questions that are now involved on this writ of error.

The decisions of this Court are numerous that in such a case this court has jurisdiction on a writ of error issued to review the judgment of a state court.

Factors & Traders Insurance Co. v. Murphy, 111 U. S. 738; 28 L. Ed. 582.
Traer v. Clews, 115 U. S. 528; 29 L. Ed. 467.
Dimock v. Revere Copper Co., 117 U. S. 559; 29 L. Ed. 994.
Palmer v. Hussey, 119 U. S. 96; 30 L. Ed. 362.
Winchester v. Heiskell, 119 U. S. 450; 30 L. Ed. 462.
Williams v. Heard, 140 U. S. 529; 35 L. Ed. 550.
Dushane v. Beall, 161 U. S. 513; 40 L. Ed. 791.
McCormick v. Market National Bank, 165 U. S. 538; 41 L. Ed. 817.
Farmers & Merchants Ins. Co. v. Dobney, 189 U. S. 301; 47 L. Ed. 821.
Crawford v. Burke, 195 U. S. 176; 49 L. Ed. 147.
Kaufman v. Tredway, 195 U. S. 271; 49 L. Ed. 190.
Thompson v. Fairbanks, 196 U. S. 516; 49 L. Ed. 577.
Humphrey v. Tatman, 198 U. S. 91; 29 L. Ed. 956.

The above are all cases in which this Court sustained its jurisdiction on writs of error issued to review judgments of state courts. Most of these cases are suits in which questions arose as to rights of parties under bankrupt acts. Several of the cases are suits by trustees in bankruptcy to recover alleged preferences, and some of the cases, including the two recent cases of *Kaufman v. Tredway*, 195 U. S. 271, and *Humphrey v. Tatman*, 198 U. S. 91, are such suits, in which judgment in the state court was rendered in favor of the trustee and against the creditors receiving the alleged preference where the judgments were reversed in this Court on writs of error sued out by the defendants in the state courts.

In the case of *Nutt v. Knut*, 200 U. S. 12-19, the Court said: "A party who insists that a judgment cannot be rendered against him consistently with the Statutes of the United States, may be fairly held within the meaning of section 709 to assert a right and immunity under such statutes, although the statutes may not give the party himself a personal or affirmative right that could be enforced by direct suit against his adversary."

Numerous authorities are there cited in support of this proposition, and cases tending to establish a contrary view are disapproved.

In *Merchants National Bank of Cincinnati v. Wehrmann*, 202 U. S. 295, where it appeared that a national bank claimed in the state court immunity from liability under the United States banking laws, it was held that such claim was sufficient to sustain the appellate jurisdiction of the United States Supreme Court, although the bank did not in the first instance anticipate the specific and qualified form in which the immunity finally was denied.

When it appears by the opinion of the State Supreme Court, which has been made a part of the record, that a Federal question was there raised and decided against the plaintiff in error, that is sufficient to confer on the United States Supreme Court jurisdiction to review such question.

San Jose Land & Water Co. v. San Jose Ranch Co., 189 U. S. 177.

Mallett v. North Carolina, 181 U. S. 589.

Taylor on Jurisdiction of U. S. Supt. Court, p. 450.

The certificate of the State Supreme Court removes any doubt that might otherwise exist in the record as to the fact that the Federal questions involved were raised and presented in the state court, and decided adversely to the plaintiff in error.

Cincinnati P. B. S. & P. Packet Co. v. Bay, 200 U. S. 179.
Merchants National Bank v. Wehrmann, 202 U. S. 295.

The Trustee Has Not Elected to Avoid, or Brought Suit to Recover, any Preference that the Bank may have Received, and the Judgment Rendered Therefor Cannot be Sustained.

This subject embraces the same general principles of law covered by the first, second, third and fourth assignments of error, and covered by "Questions Involved," number 1 and number 2.

Section 60b of the bankrupt act does not provide that a preference shall be *void*, where it is received under circumstances that it may be recovered back, but it provides that "it shall be *voidable*." The statute does not provide that it shall be voidable by creditors or by the court, but it provides that "it shall be voidable by the *trustee*."

(a) The complaint contains no allegation that the trustee elected to avoid the alleged preference by any notice or by making any demand upon the bank for the return of such preference (record 2 to 6).

The bank demurred to this complaint on this ground among others, but its demurrer was overruled. The State Supreme Court in its opinion said:

"It appears from the allegations of the complaint that the mortgaged property had been converted before the commencement of the action, and the proceeds applied upon the mortgage indebtedness of the defendant. The defendant by such conversion put it out of its power to restore the property, and under such circumstances no demand was necessary" (record 446).

In another part of the opinion the court said: "The complaint was in trover, which was proper under the circumstances" (case 454).

A transaction resulting in a voidable preference does not violate any law. The transaction is lawful when

made subject to a possibility of being defeated by subsequent events. It continues to be lawful unless it is followed by an adjudication in bankruptcy within the statutory period. It continues to be lawful after that time unless the trustee elects to avoid it.

A preference is never void, but only voidable, and no one but the trustee can elect to avoid it.

Dyer v. Kratzenstein, 92 N.Y.S. 1012.

Lewis v. First National Bank, 78 Pac. (Ore.) 990.

A creditor by merely receiving the voidable preference does not violate any legal or moral right.

Swarts v. Fourth National Bank, 117 Fed. 1-11.

Swarts v. Frank, (Mo.) 82 S.W. 60.

In *Swarts v. Fourth National Bank*, the court, in an opinion by Judge Sanborn, in speaking of certain payments that constituted a preference, said: "The acceptance of such payments was not forbidden by the moral or by the civil law. The bank did not know and could not foresee that the principal debtor on the note would become a bankrupt within four months from the payments." (117 Fed. 11)

In *Swartz v. Frank*, the court said: "The preferred creditor is not called upon to take the initiative, nor to come into court and offer to surrender his preference and prove up his claim for *non constat* that the trustee will ever attempt to treat it as voidable and to recover it. In short, under the act, the preference stands until attacked by the trustee; hence, the duty of taking the initiative rests upon the trustee and not upon the preferred creditor." 82 S.W. 60.

The creditor receiving the voidable preference is not in default until he fails or refuses to surrender it upon demand being made. Prior to that time his possession is rightful and lawful, and he is not guilty of any wrong, tort or conversion.

A creditor receiving a preference not voidable, is given the right of election by section 57g, either to return what he received and file his claim with other creditors, or else keep what he has received and not file his claim.

Piere v. Chicago Title & Trust Co., 182 U. S. 438.

Where the facts are in dispute as to whether or not a certain transaction constitutes a preference, the creditor receiving the alleged preference is by the bankrupt act necessarily called upon to determine for himself whether he will return what he has received and file his claim with other creditors, or whether he shall litigate that question and attempt to hold what he has received, in which event, in most cases, as in the case at bar, the year allowed by section 57n in which to file claims would expire without his claim being filed.

The bankrupt act therefore contemplates that the trustee shall exercise his election as to whether or not he shall avoid a preference, and it also contemplates that the creditor receiving such alleged preference must exercise an election as to what course he shall take. Until the trustee exercises his election, no cause of action accrues. The creditor is not called upon to elect what course he shall take until the trustee has acted. It therefore follows that the trustee should exercise his election and make his demand before commencing suit. The question is not a mere question of pleading or of state practice, but it goes beyond that, and involves the question of whether the property consisting of the alleged preference is any part of the trust estate, or any part of the property with which the trustee is concerned under the provisions of the bankrupt act prior to the time when the trustee elects to avoid the preference.

That a complaint in such a case is insufficient where it fails to allege such demand and refusal, we cite the following authorities:

Shuman v. Fleckenstein, Fed. Cases No. 12826.
Brooks v. McCracken, Fed. Cases No. 1932.
Lyon v. Clark, 88 N. W. (Mich.) 1046-1047.
Wright v. Skinner, 136 Fed. 694.
Capital National Bank v. Wilkerson, 72 N. E. (Ind.) 247.

(b) No suit was brought to recover the alleged preference received by the bank for which judgment was recovered. (See statement of facts under headings "Sales of Property," "Disposition of Proceeds" and "Items Comprising Judgment"; see also question No. 2 and "How Question Raised.")

The suit was brought to recover the value of logs and lumber. The evidence showed that the bank did not re-

ceive the logs or lumber (record 313, 340, 350.) The trial court held, "The bank received the notes, and not the logs and lumber" (record 399). In reference to questions 4 and 5 of the special verdict, which, when read in connection with the evidence, were ambiguous and meaningless (record 14), the Supreme Court held that "The evidence seems to clearly establish that the Lumber Company purchased the property from Young in the regular course of business, without any understanding with the defendant other than that its interest in the property as mortgagee and claimant, under numerous statutory labor liens, should be recognized, and the equivalent thereof in money delivered to it out of the proceeds" (record 448). The court also said: "The notes were but mere instruments by means of which its interest in the property was transferred to its possession in the form of money" (record 453).

It is therefore established as a verity in the case, that what the bank in fact received consisted of certain promissory notes and a small amount of money for which judgment was rendered (record 457).

The judgment against the bank was rendered on September 18, 1906, more than a year after the adjudication in bankruptcy and after the time had expired in which the bank might have surrendered any preference it may have received, and have filed its claim in the bankruptcy court under sections 57g and 57n of the bankrupt act.

The State Supreme Court was apparently of the opinion that if this was all there was to the case, that the trustee could not recover. The court said, "The very purpose of the action was to recover the value of property, logs and lumber, not notes, wrongfully converted by defendant to its own use. If the reasoning of the learned (trial) court were sound, the suggestion made by counsel for defendant that the action was brought on one theory and went to judgment on another, would not be wholly without merit" (record 449).

The court further said: "The fact is, as it seems, the defendant did in legal effect receive into its possession and convert to its use the property in question to the extent of its chattel mortgage interest" (record 449).

The court further said that it reached the conclusion that

"the legal wrong for which the defendant is liable goes back to the time the chattel mortgages were executed, and goes no further than the interest in the logs and lumber, which in the form of money finally came into its possession. The only direct interest, as appears from the uncontroverted evidence, was represented by the chattel mortgages, certain lien claims acquired by purchase, and a small amount additional that will be referred to specifically hereafter, and which was, as appears, substantially charged to it in the accounting by which the total interest in the property for which defendant was liable was arrived at" (record 447).

This "small amount additional" refers to an excess of $7, as that is the only sum afterwards specially referred to on the subject. The court after referring to this $7 said: "The amount of the judgment as we view the matter is substantially the equivalent of the property which defendant secured by its mortgages. That is, all the property as appears from the record which it obtained in fraud of the bankrupt act" (record 458).

The State Supreme Court was in error in assuming that the bank held a mortgage on the up-river logs. It appeared from the evidence (record 95-96) that there was included in one of the notes for which judgment was rendered, $1335.62 as the net proceeds of the sale of these up-river logs. The same fact appears from certain stipulated facts (record 374-375; see also statement of facts under heading "Up-River Logs").

No fraud in the transactions was either proven or found by the court or jury. It has been frequently held that except in cases of fraud, and except as to the right to recover a preference, that the trustees takes the property of the bankrupt "in the same plight and condition that the bankrupt himself held it, and subject to all the equities imposed upon it in the hands of the bankrupt."

Thompson v. Fairbanks, 196 U. S. 516, 52[illegible]

York Manufacturing Co. v. Cassell, 201 U. S. 344, 352, and cases there cited.

The plight and condition in which the trustee found the logs, the lumber and the chattel mortgages was, they had all gone out of existence so far as the bankrupt

and his estate were concerned. The logs and lumber had been sold by the bankrupt to the Waters-Clark Lumber Company for their full value, paid by that Company in cash or its equivalent. The mortgages were then cancelled, and thereafter ceased to exist as mortgages (record 56, 86). The logs and lumber were again sold to other parties before the adjudiction in bankruptcy (record 43, 44). After the mortgages were cancelled, the bankrupt took lath and shingles that had been covered by the lumber mortgage, which he sold to other parties (record 173, 223, 284). Thus far there was no preference. The sale to the Waters-Clark Lumber Company was not a preference. That company was not a creditor. The mortgages and the liens had all been paid or cancelled before the adjudication in bankruptcy. The portion of the mortgage debt that had been paid, was paid by the bankrupt out of the proceeds of the sale he had made of the property. If there was any preference, it was this payment that constituted the preference. If this preference was voidable, the trustee had the option to avoid it, because the law gave him that right. The trustee did not have the right to change into a preference that which was not preference. The law gave him no such right. The law gave him no right to substitute a fiction for a fact, by assuming that the mortgage was still in existence, and then by recovering judgment for the value of the mortgage lien.

What the bank received was not the equivalent of the mortgage lien. The mortgage covered property—lath and shingles—which was turned back to Young. While, on the other hand, more than half of the logs and more than half of their net proceeds that the bank received, were never included in the mortgages. It is the law and not the trustee that determines what constitutes a preference. The bankrupt act confers upon the trustee no power to determine that question.

If the trustee had brought suit to recover the value of the promissory notes, claiming that as a preference, could the court then hold that he should have brought suit for the value of the logs and lumber? If the trustee had demanded the return of these notes, or had brought suit for

their recovery, the bank could then have exercised its option to return the notes and file its claim in the bankrupt court. By the course that was followed, this right of the bank was denied it, and a judgment taken against it for a different claim than that for which the suit was brought, and for an alleged preference that the trustee never elected to avoid.

That it was the notes, and not the logs and lumber, that constituted the preference, if any preference was given, is also manifest for the following reasons: If the notes constituted the preference, the value of the logs and lumber was not material. If the logs and lumber constituted the preference, the value of the notes was not material. It is the value of that which constitutes the preference, and not the selling price, which fixes the measure of liability of the creditor receiving such preference.

Bankrupt Act, section 60b.

Russell v. Powell, 80 Pac. (Wash.) 837.

On a suit to recover the value of the notes, it would have been no defense, in whole or in part, to show that the bankrupt had made an advantageous sale of the property, that the property was of less value than the notes, or that there was no value in the property over and above the valid statutory liens. On the other hand, if the notes constituted the preference, and they turned out to be worthless on account of the insolvency of the maker, the creditor receiving them (in the absence of fraud) could not be required to pay their full face value.

The trustee takes the estate of the bankrupt in the plight and condition in which he finds it. When he takes from a creditor a preference, he must take that preference in the plight and condition in which the creditor received it, or else its value, which means the value of the preference which the creditor received.

Bankrupt Act, section 60b.

Besides, the transaction was in the nature of an absolute payment or transfer, and not in the nature of a mortgage or other lien. Where the lien has ripened into an absolute title by a sale of the property, the provisions of the bankrupt act relating to liens no longer apply. In such a case the remedy of a trustee, if he has any, is to treat the trans-

action as an absolute payment or transfer, and bring suit therefor under section 60b of the Bankrupt Act.

In re Bailey, 144 Fed. 214.

The suit and the relief demanded, was not of that kind or character which would be brought to set aside a mortgage lien or other lien. Any preference which the bank received and retained was not in the nature of a lien. If the bank merely held a lien, the suit would have been brought to set aside or cancel the lien, or to recover the property free from the lien. Under the bankrupt act, special provision is made by section 67 covering the subject of liens. It is provided by section 67d that liens given in good faith, and for a *present consideration*, etc., are not affected by the act.

Where a mortgage is given in part for a present consideration, and in part for an antecedent debt, it has been frequently held that the mortgage is valid as to the extent of the present conditions but invalid to the extent of the antecedent debt.

City National Bank v. Bruce, 109 Fed. 69.
In re Clifford, 136 Fed. 475.

In such a case the recovery would be of the property, subject to any valid liens existing thereon; but in a case of this kind, where the creditor received an absolute payment, any relief which the trustee could obtain must be under section 60b, under which he recovers the property that the creditor received, or its value.

In Swartz v. Frank, 82 S. W. (Mo.) 60, in a very able and well-considered opinion of the court, it was held that where the trustee waited until after the year had expired in which a creditor might file a claim in the bankruptcy court, before bringing any suit to avoid a preference, that the trustee was estopped by laches from maintaining such suit. The court there, after considering the provisions of the bankrupt act, held that the preference was not void, but voidable; that it was valid until the trustee elected to treat it as void, and that therefore the duty of taking the initiative rested upon the trustee and not upon the preferred creditor. The court said:

"A preferred creditor whose debt has been paid in cash,

or in property, has a right to regard his preference as valid until its validity is challenged by the trustee, and hence he would be very foolish to come into court and surrender his preference, and share with the general creditors before the trustee has taken any steps to have the preference declared invalid."

It therefore follows that the trustee in this case, not having elected to avoid the alleged preference for which the judgment was rendered, and not having brought suit to cover such preference, that the judgment rendered therefor is erroneous, not only as to the $1335.62, the proceeds of the logs upon which the bank never held any mortgage, but also as to the entire amount for which the judgment was recovered.

It was Error to Instruct the Jury that the Creditors were All of the Same Class.

The trial court, in charging the jury in reference to the subject of whether or not it was the intention of the bankrupt to give a preference and as to the meaning of section 60a of the Bankrupt Act, said:

"*So far as creditors' rights are involved in this action, they are all of the same class, by which is meant they would all receive the same percentage on their claims.* Claims for taxes or wages within certain times, so as to be preferred, would be of a different class; *but claims of general creditors, like those proved in the Young bankruptcy proceedings, are all of the same class*" (record 386).

Portions of the charge above quoted that are in italics, were excepted to (record 391, 392). (See assignment of error number 5, also question involved No. 3.)

The evidence showed that certain notes the bank held were secured by indorsement (record 423 to 426). The bank held certain time-checks for labor claims, which were liens on the property (record 374, 375). A large amount of other claims for labor were paid out of the proceeds of the sale (record 374, 375). The evidence shows that these claims were for wages earned by workmen and servants during the previous winter in working on logs and lumber, and that most of the wages were earned within three months prior to the time of the transfers in question (record 205,

211, 259). It also appears that certain claims were filed and allowed in the bankrupt court as preferred claims, which were probably for wages earned after the time of the transfers in question (record 99). Claims for wages were certainly not of the same class as the claims of general unsecured creditors.

In *Doyle v. Milwaukee National Bank*, 116 Fed. 296, it was held that a claim secured by indorsement was not of the same class as an unsecured claim.

The only reasonable or intelligent manner in which the jury could understand this charge was that it was a direct charge to the effect that all creditors whose claims were disclosed by the evidence, whose claims were paid out of the proceeds of the sale, or whose claims were filed as preferred claims or otherwise in the bankruptcy proceeding, were all of the same class; but that claims for taxes and certain other undefined claims for wages not connected with the suit, were of a different class. The charge was clearly erroneous and prejudicial. By the charge the bank was denied its right to have the question at issue passed upon according to law.

Error was assigned in the State Supreme Court to this charge. That court said:

"Error is assigned on the instruction to the effect that all creditors belong to one class. Whether that is right or wrong does not seem to in any way concern the case. This action, as we have indicated, is simply one in trover to recover the value of property which, as is alleged, was in fraud of the bankrupt act wrongfully converted by defendant to its own use. Whether there was one or more classes of creditors and in what manner the property sought to be recovered, would, if the suit were successful, be administered, did not vary in the slightest degree the legal rights of the plaintiff. If the property was obtained by the defendant in fraud of the bankrupt act, the plaintiff was entitled to recover the same, and this is the only question involved" (record 449).

Of course, if the bank is liable for having received a preference, it is not material to it how the money recovered from it shall afterwards be divided between other classes

of creditors; but in order to determine whether or not the bank is liable, it becomes necessary to determine whether or not it has received a preference. By the terms of the bankrupt act it has not received a preference, unless it has by virtue of the transfer in question received a greater percentage of its debt than other creditors of the same class. Bankrupt Act, section 60a.

It has been frequently held that a payment to a creditor who is entitled to priority by reason of having a claim for wages, or by reason of his having some claim placing him in a different class from other creditors, did not constitute a preference. If other creditors are in a subsequent class they are not injured by the transfer, and therefore the enforcement of the transfer does not enable the creditor receiving it to recover a greater percentage of his debt than he is entitled to.

Loveland on Bankruptcy, Second Ed. 587.
Collier on Bankruptcy, Fourth Ed. 422.
In re Henry C. King Co, 113 Fed. 110.
Doyle v. Milwaukee National Bank, 116 Fed. 295.
Easton v. Garrison, 82 S. W. (Tex.) 800.

The definition of the word "preference" in section 60a of the bankrupt act is too plain to admit of any other construction. If it is immaterial whether or not creditors are of the same class, then why are the words "same class" inserted in that section?

The State Supreme Court Erred in its Construction of the Word "Preference."

It was contended on behalf of the bank that on a proper construction of the word "preference" that the evidence was insufficient to sustain the answers to questions 9 and 12 of the special verdict, to the effect that the bank had reasonable cause to believe that a preference was intended (record 15.) In support of this contention it was shown, (1) that by virtue of the transfers in question the bank had collected only 26½ per cent. of its claim; (2) that all the other debts of Young, of which the bank had any notice, which could have been affected by the transfers under any possible view of the evidence, could not exceed $7406.90; (3) that $1962.82 would have been sufficient to enable Young to pay

these other creditors a percentage equal to that received by the bank; and (4) that according to all information the bank had, or could obtain, Young had property left more than sufficient to pay to all these other creditors a percentage equal to that received by the bank. (See statement of facts under headings, "Young's Indebtedness to Bank." See 6th assignment of error and question involved No. 4.)

Either the $4000 worth of good accounts that Young claimed to have (record 209, 210, 330, 331), or the 40 acres of land, wagons, sleighs and camp outfit worth over $2000.00 (record 90, 315, 421), or the $1500 worth of lath and shingles (record 90, 315), together with several carloads of lumber that Young sold after February 1st (record 218 to 223), or the $2000 in cash that he claimed to have in his pocket (record 87), would have been amply sufficient to pay these other creditors a greater percentage than that collected by the bank.

It was also contended that on such state of facts the bank had not received a preference (record 456).

If, on a proper construction of the bankrupt act, the evidence was insufficient to sustain the finding of the jury, it would have been the clear duty, as well as the uniform practice in such cases, for the State Supreme Court to have set aside the finding of the jury.

Stafford v. Chippewa Valley Electric Railroad Company, 110 Wis. 331, 361, and cases there cited.

The State Supreme Court held that the evidence was sufficient to prove that Young was insolvent, and also to prove that the bank was chargeable with notice thereof. (See opinion of court and evidence referred to, record 454, 455.) The court held that because the evidence was sufficient to prove that Young was insolvent, and that the bank was chargeable with notice of such insolvency, that the conclusion followed that the evidence was sufficient to prove that the bank was chargeable with notice that a preference was intended (record 456).

An examination of the court's opinion will show that this is the only fair or reasonable construction that can be given to the opinion. If the opinion is examined in the light of the evidence to which it refers, then it is very clear that the

question of the sufficiency of the evidence to sustain these findings depends entirely upon whether or not the State Supreme Court placed a proper construction upon the meaning of the word "preference." The construction which the court placed upon the statute appears from the following portion of the opinion: "It is claimed, however, by counsel for defendant, that unless the enforcement of the mortgages would operate to give defendant a greater percentage of its debt than other creditors of the same class would receive, that the mortgages did not amount to a conveyance of property, or in other words, a preference, within the meaning of the bankrupt act. We do not so understand the law. The Federal statute renders void any preference given under the circumstances specified therein, and, as we have seen, gives the trustee in bankruptcy the right to recover any property, or its value, conveyed in violation of such act. Manifestly, if a creditor receives security for the payment of his claim, and that is followed within four months by the commencement of proceedings in bankruptcy against or on the part of the debtor, the intention of such security being to give the favored creditor a preference (the having knowledge or reasonable means of knowledge thereof), and yet have the same standing as other creditors for the balance of his claim, as he would have if the transaction were valid, the effect would necessarily be to give such creditor an undue advantage, a preference within the meaning of the bankrupt act. That is too clear to admit of a reasonable controversy. Toof et al. v. Martin, 13 Wall. 40" (record 456).

The question presented to this Court on this writ of error is, Did the Supreme Court, in deciding the question of fact, place an improper construction upon this Federal statute? If it did, then the bank has been denied a right and immunity which it specially set up and relied upon under this Federal statute which was decided against it in the state court. Unless this Court can give it relief in such a case, then, although it may not be liable either under the facts or under the law, it will be deprived of its property by the judgment rendered, with no court to give it relief. It is a self-evident proposition, that the bank did not have a reasonable cause to believe that a preference was intended, if all the facts and circumstances that it

knew and with which it was chargeable with knowledge did not in the law constitute a preference.

By the terms of the bankrupt act a transaction does not constitute a preference unless the enforcement of the transfer (whether by sale, payment or mortgage) has the effect to enable one creditor to obtain a greater percentage of his debt than other creditors of the same class.

Section 60a of the bankrupt act, so far as it applies to this question, reads as follows:

"A person shall be deemed to have given a preference if, being insolvent, he has * * made a transfer of any of his property, and the effect of the enforcement of such * * transfer will be to enable one of his creditors to obtain a greater percentage of his debt than any other of such creditors of the same class."

By the terms of the statute it is not sufficient that the debtor be insolvent, and that some transfers or payment be made to a creditor, but the transfer or payment to the creditor must be sufficient in amount to constitute a "greater percentage." The "greater percentage" must be the effect of the enforcement of the transfer.

The words are plain that "the effect of the enforcement of the transfer *will be* to enable one of his creditors to obtain a greater percentage," etc. It does not say that the transfer is a preference, if that result *may* follow, but only when that result *will* follow as the effect of the transfer. It is impossible to construe the statute as construed by the state court without changing the language of the statute. As the statute is construed by the state court, the words, "and the effect of the enforcement of such transfer will be," etc., must be changed so as to read, "and the *combined* effect of the enforcement of such transfer, *together with a collection of the balance of the claim with other creditors in a subsequent bankrupt may be*," etc., or, to meet that court's construction, the clause in question must be changed so as to read, "and the effect of the enforcement of the transfer will be to enable any one of his creditors to obtain any percentage of his debt." Besides, as the act was construed, it is necessary to

strike out entirely the words, "any other of such creditors of the same class," because the court has held that it in no way concerns the bank, whether or not creditors are all of one class.

No authority is cited in the court's opinion to sustain its construction, except that of *Toof et al. v. Martin*, 13 Wallace, 40. That case was decided under section 35 of the bankrupt act of 1867, which covered the same general subject as section 60 of the bankrupt act of 1898. Section 35 of the bankrupt act of 1867 did not contain any provision in reference to the percentage of the claim collected by reason of the transfer, but provided in substance that if a person, being insolvent, makes any payment or transfer to a creditor, such creditor "having reasonable cause to believe such person *insolvent*," that the transaction should be void.

It is not the policy of the bankrupt act of 1898 to make it the duty of all insolvent persons to be adjudged bankrupts. Only certain persons may become voluntary bankrupts, and only certain persons may be adjudged involuntary bankrupts.

Bankrupt Act, section 4.

Many insolvent persons succeed in paying their debts. It is only when an unfair and unequal distribution of the insolvent's property, is made between his creditors, that such distribution becomes a preference. If an insolvent person makes an equitable division of his property among his creditors, it is much better, both for the debtor and the creditors, that this be done without any bankruptcy proceedings.

From the nature of business, absolute equality of distribution is impossible. It is necessary, in order that business interests be not unduly disturbed, that a time limit of four months, or some other reasonable time, be established, beyond which the transactions cannot be set aside as preferences. The result is that creditors who collect their claims beyond a time limit secure an advantage over other creditors. Creditors who collect their claims, or portions of their claims, within the four months, without being chargeable with notice that a preference was intended, also secure an advantage over other creditors. It was the intention of

congress, in order not to disturb fair business transactions, that such advantage should not be disturbed. The intention of congress is carried out further along this line by the amendment in 1903 to section 57g, which permits a creditor who receives a preference not voidable under section 60b to retain the preference and collect the balance of his claim out of the bankrupt's estate. These considerations show that when congress provided by section 60a that in order to constitute a preference, the effect of the enforcement of the transfer must be to secure to the creditor receiving it a greater percentage of his debt than other creditors of the same class, that it was the intention that this provision should mean just what it said, and that it should not be extended by construction to include other transactions not coming within the provisions of the act.

In *New York County National Bank v. Massey*, 192 U. S. 138, where a bank applied upon its claim against an insolvent debtor money on deposit in the bank, the court held that the transaction did not constitute a preference. It was held that, although the transaction gave the creditor an advantage over other creditors, that it did not constitute a preference within the meaning of the bankrupt act, because "this indirect result is not brought about by the transfer of the property within the meaning of the law."

The authorities are numerous to the effect that a payment or transfer by an insolvent debtor does not constitute a preference, unless it has the effect to enable one creditor to obtain a greater percentage of his debt than other creditors of the same class.

In re Henry C. King Co., 113 Fed. 110.
Swarts v. Fourth National Bank, 117 Fed. 1-4.
Loveland on Bankruptcy, Second Ed. 572, 577.
Collier on Bankruptcy, Fourth Ed. 422.
Christoferson v. Oleson, 102 N. W. (S. D.) 685.
Sellers v. Hayes, 163 Ind. 422; 72 S. E. 119.
Peterson v. Nash Bros., 112 Fed. 311.
Hastings v. Tithian, 60 Atl. (N. J.) 350.

In *Peterson v. Nash Brothers*, 112 Fed, 311-314, the court in speaking of section 60a said: "This provision it seems

does not make the transfer of property (which includes the payment of money) by an insolvent debtor in and of itself a preference. It must be so done that the effect of the transfer will be to enable one creditor to obtain a greater percentage of his debt than any other creditor of the same class".

In *re Henry C. King Co.*, 113 Fed. 110-111, the court said: "The bankrupt act does not provide that any payment received by the creditor from the bankrupt within four months is a preference, but only when the effect of this payment, 'will be to enable any one of his creditors to obtain a greater percentage of his debt than any other of his creditors of the same class.' If this is not the effect of the payment there is no preference."

The court further said: "Bankrupt Act, section 60b, does not provide that the trustee may recover all payments received with knowledge of insolvency, but only preferences so received. This seems to be the inevitable result of *Dickson v. Wyman*, combined with *Piere v. Trust Co.* I must hold therefore that knowledge of insolvency did not make a preference of acts which otherwise did not amount to a preference."

In *Swarts v. Fourth National Bank*, 117 Fed. 1-4, the court said: "The test of a preference under the act is the payment out of the bankrupt's property of the larger percentage of the creditors' claim than other creditors of the same class receive, and not the benefit or injury to the creditor preferred."

In *Loveland on Bankruptcy*, on page 577, the author, in discussing what is reasonable cause to believe that a preference was intended, said: "This phrase undoubtedly includes reasonable cause to believe that the debtor is insolvent, for this is one of the elements of a preference. It also includes a reasonable cause to believe that he is to obtain a greater percentage of his debt than any other creditor in his class, for this is another element of a preference."

In *Christoferson v. Oleson*, (S. D.) 102 N. W. 685, the court, in considering the question of what constitutes a voidable preference, said: "In other words, when a bankrupt who is insolvent, conveys to a creditor *more than his proportion of*

his property, and the creditor so receiving such transfer or to be benefitted thereby shall have reasonable cause to believe that it was thereby intended to give him a preference, such transfer is void if made within four months of the adjudication, or declaration that he is a bankrupt". (686.)

The Trustee Represents Creditors who are Entitled to Participate in the Distribution of the Bankrupt Estate, and No Recovery Can be had Except for their Benefit.

This proposition involves the questions raised by the first, seventh, eighth and ninth assignments of error, and by question involved No. 5. See also statement of facts under headings, "Young's Indebtedness to Other Creditors" and "Illegal Preferences Collected by Other Creditors."

(a) If the trustee can maintain the suit only on behalf of creditors whose claims are administered in the bankrupt proceeding, the complaint fails to state a cause of action, and the demurrer thereto should have been sustained. The complaint contains no allegation that the claim of any creditor was filed in the bankrupt court.

The State Supreme Court in passing on this question held that under section 60 of the bankrupt act that it was not necessary to allege that any claim had been filed in the bankruptcy proceeding, or any fact showing the necessity of recovering the alleged preference to pay claims of creditors; that where the preference was voidable, the trustee has the absolute right to recover the value of the property without any condition or exception (record 446).

In a suit by a trustee in bankruptcy to recover an alleged preference, the complaint is insufficient when it fails to allege that claims of creditors have been filed in the bankruptcy proceeding.

Roney v. Conable, 101 N. W. (Ia.) 505.
Crary v. Kurtz, 105 N. W. (Ia.) 590-591.
Lesser v. Bradford, 95 N. Y. S. 933.
Mueller v. Bruss, 112 Wis. 406.

In the case at bar the State Supreme Court distinguished the case from the decision in *Mueller v. Bruss*, on the ground that in *Mueller v. Bruss* the suit was brought to set aside a fraudulent conveyance, while in the case

at bar the suit was brought to recover a preference. We think that no such distinction is justified by any provision of the bankrupt act, and that if the trustee represents creditors in the one case, he also represents creditors in the other. We fail to see how the existence of actual fraud on the part of the creditor receiving the conveyance would increase his rights.

(b) If the trustee bringing this suit represents creditors, and if his recovery is limited to such sum as is necessary to pay in full the claims of such persons as the evidence in this suit shows were creditors whose claims were proven and entitled to be proven in the bankrupt court, then no recovery can be justified in excess of $2667.04 (see statement of facts under headings, "Young's Indebtedness to other Creditors." and "Illegal Preferences Collected by Other Creditors").

The evidence shows that the claims of all creditors who could in any manner be affected by the alleged preference, whose claims were filed in the bankruptcy proceeding, amounted to $8322.18 (record 98, 99 and 144 to 148).

The record also shows that two of these creditors, Sallie F. Moon and W. S. Monroe, whose claims amounted to $5655.14, had themselves received preferences. Deducting this sum of $5655.14 from $8322.18, leaves $2667.04.

The bankrupt act prohibits the filing or allowance of claims of persons who received and failed to return preferences.

Bankrupt Act, section 57g.

Piere v. Trust Company, 182 U. S. 438.

In a suit of this kind the burden is upon the trustee to prove his case, which necessarily means both the question of his right to recover and the question of the amount of his recovery.

Evidence was offered to prove what debts the bankrupt was owing on Feb. 20, 1902 (record 144 to 148). The evidence also shows that he was owing substanially the same debts on March 29, 1902 (record 210, 211). There is no evidence to show what debts he was owing at any subsequent date. Certain claims were filed and allowed in the bankruptcy preceeding (record 98, 99) not included in the amount

above mentioned of $8322.18. No evidence was offered to prove that the bankrupt ever owed any of these other debts.

Ex parte affidavits filed in the bankrupt court were no proof in this suit against the bank of the existence of any such indebtedness.

Halbert v. Pranke, (Minn.) 97 N. W. 976.

Besides, when this proof was offered it was expressly stated by counsel for the trustee that it was not offered for the purpose of proving the existence of any such alleged indebtedness, but merely for the purpose of proving that certain claims were filed (record 263).

In a suit by a trustee against a creditor to recover an alleged preference, the creditor is entitled to have the suit decided upon evidence adduced on the trial in that suit, and is not bound by any judgment or decision that may have been rendered in the bankrupt court, either as to a question of preference, a question of insolvency, or any other material question in the case.

Buder v. Columbia Distilling Co., 70 S. W. 508.
John Silvey & Co. v. Taft, 123 Ga. 804; 51 S. E. 748.
Loveland on Bankruptcy, Second Ed. 609.

It is elementary that where a party is sued there he has a right to defend. His right to defend involves the right to defend, not only as to the question of his liability, but also the question of the amount of that liability. That right cannot be taken from him by any proceeding in another court, where he was not a party and where he was not represented.

The question of the amount of the claims of creditors was not found in the state court by either the court or jury. The State Supreme Court refused to consider the question on the ground that under the bankrupt act a creditor receiving a voidable preference was absolutely liable for its entire value, and that therefore the amount of creditors' claims was immaterial.

The claims filed in excess of $8322.18 are therefore unsupported by any evidence, or by any finding or decision in the state court. The claim of one of the creditors who received a preference, which claim was filed in the bankrupt court, shows on its face the fact that, nowith-

standing the creditor had no security, the bankrupt had paid on the claim $1059.86 within four months before the adjudication in bankruptcy, which sum was credited on the claim, instead of being surrendered as the bankrupt act provided (record 264). This claim was not entitled to be so filed under the law.

Western Tie & Timber Co. v. Brown, 196 U. S. 500, 510.

As the claim is not by law entitled to be filed in the bankrupt court, the trustee under the law has no right in this suit to sue or recover for the benefit of such creditor.

Under the bankrupt act one creditor who receives and retains a preference has no standing in court to keep that preference and also by the assistance of the trustee to require another creditor who has received a similar preference to pay the balance of the claim. If this judgment is sustained that will be the result.

Under the bankrupt law the bank is not liable for the claim of Sallie F. Moon. It appears from the certificate of the Chief Justice of the State Supreme Court, that in the decision of the case these questions were raised and presented to the court, and by it decided adversely to the plaintiff in error (record 466, 467).

The fact that the State Supreme Court in its decision found it necessary, as the Chief Justice certifies, to decide these questions adversely to the bank, necessarily means that the decision of the State Supreme Court is based upon its decision of these questions.

We think that on principle and authority a trustee, in order to recover a voidable preference, must be required to established, not only that the transaction constituted a voidable preference, but also the following facts:

First—That other creditors of the bankrupt in fact existed;

Second—That such creditors have filed claims in the bankrupt court;

Third—That the claims of such creditors were such that under the bankrupt law they were entitled to be so filed.

The trustee ought not to be permitted to recover anything for the payment of any claim that fails to comply with any one of the above three requirements. Any additional amount recovered is in the nature of a penalty or forfeiture.

Claims of persons not proven to be creditors are necessarily fictitious claims. It cannot be the duty of the defendant in such a suit to prove that A, B or C is not a cerditor, when no proof is offered and no claim made that such person is a creditor.

A transfer by an insolvent debtor to a creditor is not a preference unless it appears that the debtor had other creditors existing at the time of the transfer.

Brake v. Callison, 129 Fed. 201.

A trustee in bankruptcy is the trustee for the creditors, and represents general creditors who are entitled to participate in the bankrupt estate.

Dudley v. Easton, 104 U. S. 99.

The fact that a trustee represents creditors, and sues in their behalf, is manifest from the nature of the proceeding. He is elected by the creditors. In recovering the assets of the estate he occupies a similar position to that of a receiver, an assignee for the benefit of creditors, an executor or an administrator. It is elementary that in suits by such other officers to recover property conveyed in violation of the rights of creditors, that the recovery is limited to what is necessary to pay the claims of creditors. That the trustee occupies the same position is implied by his name. In such a suit for whom is he trustee unless it be for creditors? Can he recover a preference not needed to pay debts, but only for the purpose of returning it to the bankrupt after the debts are paid under section 66b of the bankrupt act? He cannot recover anything in his own behalf, and for his own benefit. Unless he is trustee for the creditors, for whom is he trustee? Can there be a trustee without a *cestui que trust?*

The State Supreme Court held that the right to recover was not limited to what was necessary to pay creditors, because section 60b did not in terms so provide.

As said by other courts, "Notwithstanding any provisions which are found in the bankruptcy act relative to the right of the trustee to avoid particular transactions of the debtor, yet the whole act must be read in the light of the predominating purpose of congress with reference to the distribution of the assets, namely, to prevent any inequality of payment among the unsecured creditors."

Sellers v. Hayes, 72 N. E. (Ind.) 119-122.

It is elementary in the construction of statutes that they should be construed according to the intent for which the statute was enacted, and that no construction which would lead to unreasonable or ridiculous results will be adopted, if any other reasonable construction is possible.

An illustration will show what would be possible under the construction adopted by the State Supreme Court. Suppose an insolvent person had property worth $75,000 and owed debts to the amount of $100,000; that he owed one creditor $99,000, and owed ten other creditors $100 each? He pays his largest creditor $70,000. The creditor knows that he is insolvent, but also knows that he has $5000 left, which is more than sufficient to pay his other ten creditors the $1000 he owes. He files a petition in bankruptcy. His trustee sues and recovers the $70,000 from the preferred creditor. In the meantime the bankrupt is discharged from his debts, and the time has expired for the preferred creditor to file his claim in the bankruptcy court. The other creditors are paid out of the $5000 the bankrupt had left, and the balance, including the $70,000, is returned to the bankrupt; or, suppose we change the situation a little, to make it more like the case at bar. Suppose the trustee, instead of suing to recover the preference of $70,000, brings suit to recover a much larger sum which he alleges was the value of logs and lumber sold to the creditor, but which in fact was never sold to nor received by the creditor, and suppose that after the year expired for that creditor to file his claim, and at a time when the trustee had not yet elected to avoid any actual preference that was received, the trustee is permitted in that suit to recover a judgment, not for what he sued for, but for the $70,000, which, when recovered, must be returned to the bankrupt. In both such cases the bankrupt would have all his debts discharged, and would have made a very handsome profit out of the transaction.

We think that a construction of the bankrupt act which would make such a result possible is an unreasonable construction, and cannot be sustained.

We think in the supposed case that the creditor receiving

the $70,000 is not liable at all; first, because the transaction is not a preference, as the creditor did not receive more than his just proportion; second, because the trustee did not elect to avoid, and did not bring suit to recover, the alleged preference that the creditor received, and third, because the recovery was not necessary to pay the bankrupt's debts.

We therefore respectfully submit that an examination of the record in this case discloses that in the decision of this suit in the state court, an entirely erroneus construction was placed upon the provisions of the bankrupt act in many material particulars, that the rights to which the plaintiff in error was entitled under that law were denied it, and that the judgment should be reversed.

Respectfully submitted,

BURR W. JONES,
JAMES WICKHAM,
FRANK R. FARR,
Counsel for Plaintiff in Error.